

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

ASSET PRESENTATION ON MILITARY DEPARTMENT GENERAL FUND FINANCIAL STATEMENTS

Report No. 97-100

February 25, 1997

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Department of Defense

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Acronyms

CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
FEDGAAP	Federal Generally Accepted Accounting Principles
GLAC	General Ledger Account Code
IG	Inspector General
OMB	Office of Management and Budget
PP&E	Property, Plant and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
USD(C)	Under Secretary of Defense (Comptroller)

February 25, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Audit Report on Asset Presentation on Military Department General Fund
Financial Statements (Report No. 97-100)

We are providing this audit report for review and comments. In preparing the final report, we considered comments from the Under Secretary of Defense (Comptroller) and the Federal Accounting Standards Advisory Board on a draft of this report.

The management comments from the Under Secretary of Defense (Comptroller) were not responsive and left two unresolved issues: the financial statement presentation of war reserves and progress payments on Military Department General Fund financial statements. Although the Under Secretary of Defense (Comptroller) recently revised the guidance for presenting war reserves and progress payments on the financial statements, the guidance was not in accordance with Federal Generally Accepted Accounting Principles. The Under Secretary of Defense (Comptroller) should present war reserves as a separate line item and coordinate with the Federal Accounting Standards Advisory Board and the Office of Management and Budget to clarify accounting guidance for presenting progress payments.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Under Secretary of Defense (Comptroller) reconsider his position and provide additional comments on this final report by April 25, 1997.

The courtesies extended to the audit staff are appreciated. Questions about this audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (703) 604-8868 (DSN 664-8868; e-mail rbird@DODIG. OSD.MIL); or Mr. John J. Vietor, Audit Project Manager, at (317) 542-8855 (DSN 699-8855; e-mail jvietor@DODIG. OSD.MIL). The distribution of this report is listed in Appendix D. The audit team members are listed inside the back cover.



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Office of the Inspector General, DoD

Report No. 97-100
Project No. 5FI-2012.03

February 25, 1997

Asset Presentation on Military Department General Fund Financial Statements

Executive Summary

Introduction. We reviewed assets presented on the Military Department General Fund Financial Statements to determine whether they were presented consistently. Included in our review were assets such as supplies; inventories; and property, plant and equipment. These assets are presented on lines 1.d. through 1.l. of the Army and Air Force General Fund Statements of Financial Position. This report provides a basis for ensuring that these assets, estimated at \$1.1 trillion, will be presented consistently on FY 1996 and future Military Department General Fund Financial Statements and FY 1996 and future DoD Consolidated Financial Statements, in accordance with guidance from the Federal Accounting Standards Advisory Board and the Office of Management and Budget.

Objective. The audit objective was to identify and summarize the reasons for and offer solutions to the inconsistent presentation of assets of the Army and Air Force, as shown on their FYs 1994 and 1995 General Fund Financial Statements.

Audit Results. The Defense Finance and Accounting Service (DFAS) Centers incorrectly and inconsistently presented assets on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements. Specifically, the DFAS Centers incorrectly and inconsistently presented:

- o at least \$31.3 billion of war reserves for the Army and an additional but unquantified amount for the Air Force (Finding A), and
- o about \$10.5 billion of progress payments (Finding B)

Unless the DFAS Centers prepare Military Department General Fund financial statements that correctly and consistently present assets, the FY 1996 and future Military Department General Fund Financial Statements, the FY 1996 and future DoD Consolidated Financial Statements, and the FY 1997 and future Government-Wide Consolidated Financial Statements will be materially misstated. The inappropriate presentation of these assets on the financial statements will remain an obstacle to rendering audit opinions on the Military Department General Fund financial statements.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) clarify accounting guidance for presenting war reserves and progress payments on the financial statements. Specifically, accounting guidance should state that on future DoD financial statements, war reserves should be presented as a separate line item, and progress payments should be consistently presented by the DFAS Centers.

Management Comments. The Under Secretary of Defense (Comptroller) nonconcurred with our recommendations to present assets consistently by clarifying accounting guidance for presenting war reserves and progress payments on financial statements. However, he stated that the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996, requires war reserves to be included on the Inventory, Net line of the financial statements, and that guidance on the financial statement presentation of progress payments for weapon systems was recently clarified to ensure consistency. We also requested and received unofficial comments from the Federal Accounting Standards Advisory Board. The Federal Accounting Standards Advisory Board did not comment on the recommendations, but provided background information for us to consider in finalizing the audit report. See Part I for a summary of management comments and Part III for the text of management comments.

Audit Response. The management comments were not responsive. The Under Secretary of Defense (Comptroller) disagreed with the recommendations to present war reserves on a separate line of the financial statements and the need to coordinate with the Federal Accounting Standards Advisory Board and the Office of Management and Budget to clarify accounting guidance for presenting progress payments on the financial statements. The Office of the Under Secretary of Defense (Comptroller) stated that they had recently taken action to address the two issues of asset presentation. However, this action will not enable the DoD accounting community to present war reserves and progress payments in accordance with Federal Generally Accepted Accounting Principles. The report was revised where appropriate, based on comments from the FASAB. A summary of our response to the management comments is in Part I. We request that the Under Secretary of Defense (Comptroller) reconsider positions taken on the two issues and provide additional comments by April 25, 1997.

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Part I - Audit Results

Audit Results

Audit Background

Public Law. Public Law 101-576, the Chief Financial Officers (CFO) Act of 1990, requires the annual preparation and audit of financial statements for trust funds, revolving funds, and substantial commercial activities of Executive departments. The consistent and uniform preparation of financial statements became increasingly important with the passage of Public Law 103-356, the Government Management Reform Act of 1994. Public Law 103-356 requires DoD to consolidate the Military Departments' financial statement data and issue DoD-wide audited financial statements beginning in FY 1996 and annually thereafter. Public Law 103-356 also requires FY 1997 Government-Wide Consolidated Financial Statements.

Guidance on Accounting Policies. Guidance for presenting assets on financial statements is found in:

- o Statements of Federal Financial Accounting Standards (SFFAS) and Concepts, known as Federal Generally Accepted Accounting Principles (FEDGAAP) when published by the Office of Management and Budget (OMB);
- o OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 29, 1993 (the "November 1993 OMB Form and Content"). The "November 1993 OMB Form and Content" was recently superseded by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996 (the "October 1996 OMB Form and Content");
- o "DoD Guidance on Form and Content of Financial Statements for FY 1994 and FY 1995 Financial Activity," October 20, 1994 (the "October 1994 DoD Guidance on Form and Content"). This guidance expands on the "November 1993 OMB Form and Content" and includes items that are specific to the preparation of DoD financial statements. The "October 1994 DoD Guidance on Form and Content" was recently superseded by "DoD Guidance on Form and Content of Financial Statements for FY 96 Financial Activity," October 1996 (the "October 1996 DoD Guidance on Form and Content"); and
- o DoD 7000.14-R, the "DoD Financial Management Regulation," volume 4, "Accounting Policies and Procedures," January 11, 1995.

When determining which guidance to follow for preparing the Military Departments' financial statements, the Defense Finance and Accounting Service (DFAS) Centers must follow the hierarchy of accounting policy guidance in the "November 1993 OMB Form and Content." Although the "November 1993 OMB

"Form and Content" was recently superseded, it was the criterion for the FYs 1994 and 1995 financial statements reviewed during this audit. See Appendix B for further details, including the hierarchy of guidance.

Assets Reviewed. We reviewed all material assets on the Statement of Financial Position except Fund Balance with Treasury to determine whether those assets were consistently presented. The assets included in our review were inventories; work in process, supplies; stockpile materials; property, plant and equipment (PP&E); and other entity assets. These assets are presented on lines 1.d. through 1.l. of the Army and Air Force General Fund Statements of Financial Position. The "November 1993 OMB Form and Content" and the "October 1994 DoD Guidance on Form and Content" (as updated by the "October 1996 OMB Form and Content" and the "October 1996 DoD Guidance on Form and Content") define the asset line items we reviewed as follows.

Work in Process. The "November 1993 OMB Form and Content" does not define Work in Process as a separate line item on the financial statements. The "October 1994 DoD Guidance on Form and Content" defines Work in Process as that which:

... represents the net value of accumulated costs of materials, labor and overhead, performed by DoD personnel, reported by contractors, other Federal Agencies, property furnished by the DoD to contractors for inclusion in, or fabrication of an end item, costs of all capital assets developed or manufactured for other Defense Business Operations Fund activities, and the estimated amount of loss due to breakage, spoilage, obsolescence, etc.

The "October 1994 DoD Guidance on Form and Content" required that information on Work in Process be disclosed in Footnote 9 of the financial statements. The definition of Work in Process in the "October 1996 DoD Guidance on Form and Content" is identical to the "October 1994 DoD Guidance on Form and Content," including the footnote.

Inventory, Net. Inventory is tangible personal property that is held for sale, including raw materials and work in process; in the process of production for sale; or to be consumed in the production of goods for sale or in the provision of services for a fee. The "November 1993 OMB Form and Content" classified Inventory, Net as a separate line on the financial statements, with additional information to be disclosed in Footnote 8. The "October 1996 OMB Form and Content" does not alter the definition of Inventory. However, it establishes an undefined line entitled Inventory and Related Property, Net, which consists of the following categories: Inventory, Operating Materials and Supplies, Stockpile Materials, Seized Property, Forfeited Property, and Goods Held Under Price Support and Stabilization Programs.

Audit Results

Operating Materials and Supplies, Net. Operating Materials and Supplies consist of tangible personal property to be consumed during normal operations. The "November 1993 OMB Form and Content" classified Operating Materials and Supplies as a separate line on the financial statements, with additional information to be disclosed in Footnote 9 (Footnote 10 in the "October 1994 DoD Guidance on Form and Content"). The "October 1996 OMB Form and Content" no longer classifies Operating Materials and Supplies as a separate line, but discloses it in Footnote 8 as a category under Inventory and Related Property (Footnote 10 in the "October 1996 DoD Guidance on Form and Content"). The definition of Operating Materials and Supplies remains the same in the "October 1996 OMB Form and Content" and the "October 1996 DoD Guidance on Form and Content" as in the "November 1993 OMB Form and Content" and the "October 1994 DoD Guidance on Form and Content."

Stockpile Materials, Net. Stockpile Materials are strategic and critical materials held due to statutory requirements for use in national defense, conservation, or national emergencies. They are not intended for sale in the ordinary course of business. The "November 1993 OMB Form and Content" classified Stockpile Materials as a separate line on the financial statements, with additional information to be disclosed in Footnote 10 (Footnote 11 in the "October 1994 DoD Guidance on Form and Content"). The "October 1996 OMB Form and Content" no longer classifies Stockpile Materials as a separate line, but discloses it in Footnote 8 as a category under Inventory and Related Property (Footnote 11 in the "October 1996 DoD Guidance on Form and Content"). The definition of Stockpile Materials remains the same in the "October 1996 OMB Form and Content" as in the "November 1993 OMB Form and Content." However, the definition of Operating Materials and Supplies in the "October 1996 DoD Guidance on Form and Content" was changed from the definition in the "October 1994 DoD Guidance on Form and Content" to include only those items held pursuant to the Strategic and Critical Materials Stockpiling Act of 1979.

Property, Plant and Equipment, Net. According to the "November 1993 OMB Form and Content" and the "October 1994 DoD Guidance on Form and Content," Property, Plant and Equipment (PP&E) is real and personal property (land, structures and facilities, construction in progress, purchased and self-developed software, equipment, and related improvements) that has been capitalized, less accumulated depreciation, if any. PP&E also includes assets acquired through capital leases and leasehold improvements and property owned by the reporting entity that is in possession of the reporting entity or contractors. The "November 1993 OMB Form and Content" required that the components of PP&E, as well as information on depreciation practices, if any, be disclosed in Footnote 14 of the financial statements (Footnote 15 in the "October 1994 DoD Guidance on Form and Content"). The definition of PP&E in the "October 1996 OMB Form and Content" was changed from the definition in the "November 1993 OMB Form and Content" to reflect the requirements of SFFAS No. 6, "Accounting for Property, Plant, and Equipment." However, the definition of

PP&E in the "October 1996 DoD Guidance on Form and Content" was not changed to reflect the requirements of SFFAS No. 6 and is identical to the definition of PP&E in the "October 1994 DoD Guidance on Form and Content."

Other Entity Assets. The "November 1993 OMB Form and Content," the "October 1994 DoD Guidance on Form and Content," and the "October 1996 DoD Guidance on Form and Content" state that Other Entity Assets includes other assets that are not classified as intragovernmental or governmental and are not included in Work in Process; Operating Materials and Supplies, Net; Stockpile Materials, Net; or PP&E, Net. If the components of Other Entity Assets are material, they should be disclosed in a footnote.

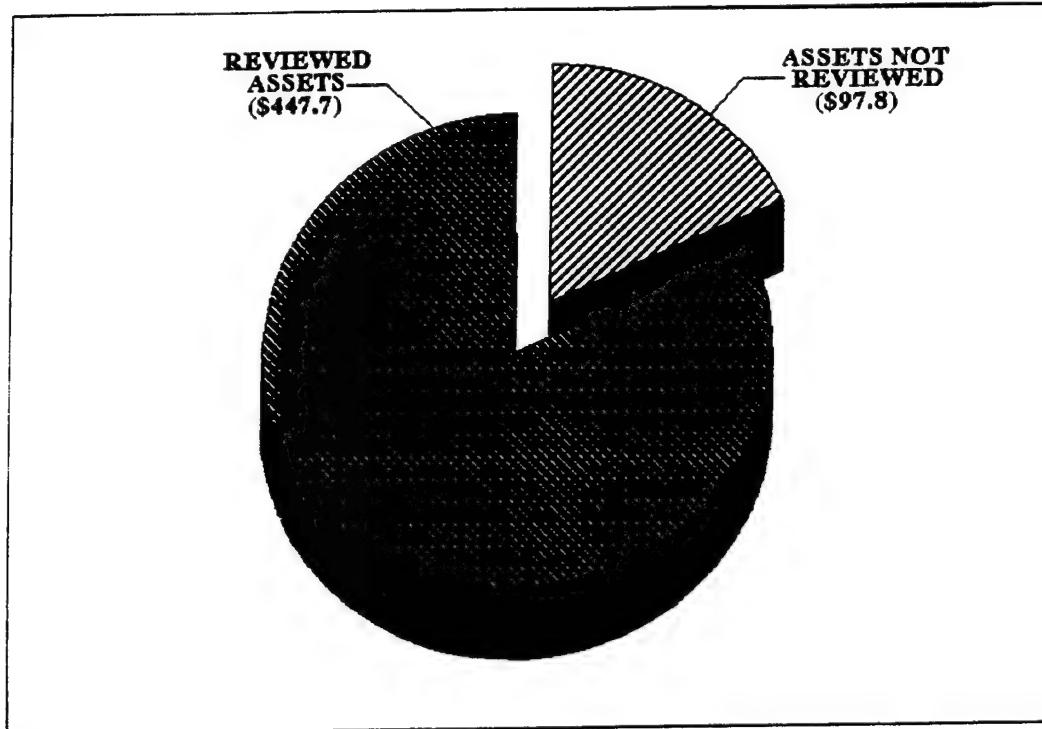
Significance of Assets Reviewed and Apparent Inconsistencies in Presentation. The assets reviewed for consistency on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements represented 82 percent of total assets. Total assets are valued at over \$500 billion. The DFAS Centers prepared financial statements in FYs 1994 and 1995 for the Army and Air Force general funds. As shown in Table 1, the Army and Air Force assets we reviewed, as reported on their financial statements by the DFAS Indianapolis Center and the DFAS Denver Center, contained apparent inconsistencies. For example, in FY 1995, the DFAS Indianapolis Center showed \$31.3 billion of assets for Stockpile Materials, although the DFAS Denver Center showed no assets for Stockpile Materials.

**Table 1. General Fund Financial Statement
Data for Assets Reviewed (Billions)
(by Fiscal Year)**

Entity Assets Reviewed Assets:	1994		1995	
	Army	Air Force	Army	Air Force
Inventory, Net	\$ 2.0	\$ 0	\$ 1.9	\$ 0
Work in Process	0	9.9	0	0
Operating Materials and Supplies, Net	0	32.3	0	23.9
Stockpile Materials, Net	30.5	0	31.3	0
Property, Plant and Equipment, Net	160.4	227.6	155.9	234.5
Other Entity Assets	7.2	0	0.2	0
Total Reviewed Entity Assets	\$ 200.1	\$ 269.8	\$ 189.3	\$ 258.4
Total Assets	\$ 233.7	\$ 330.9	\$ 221.7	\$ 323.8

Audit Results

Because these apparent inconsistencies are material to the Army and Air Force financial statements, we attempted to identify and summarize the reasons for them and offer solutions. The assets reviewed accounted for about 82 percent (\$447.7 billion of \$545.5 billion) of total assets on the FY 1995 Army and Air Force General Fund Financial Statements, as shown in the figure below.



Significance of Assets Reviewed in FY 1995 (billions)

Until these assets are consistently presented on the Army and Air Force General Fund financial statements, the FY 1996 and future DoD Consolidated Financial Statements will be materially misstated.

Financial Statement Audits of Army and Air Force General Funds. The General Accounting Office and the Army and Air Force audit agencies, in coordination with the IG, DoD, have performed financial statement audits of Army and Air Force General Funds since FY 1988. The auditors disclaimed opinions on all Army and the Air Force General Fund financial statements since FY 1988. The Navy and Defense agencies' General Fund financial statements have not yet been audited.

as the FY 1996 DoD Consolidated Financial Statements. The General Accounting Office will audit and render or disclaim an opinion on the FY 1997 Government-Wide Consolidated Financial Statements. Consistent presentation of DoD assets on the financial statements is needed to facilitate these audits.

Audit Objective

The objective of this audit was to identify and summarize the reasons for and offer solutions to the problem of inconsistent presentation of assets of the Army and Air Force, as shown on their FYs 1994 and 1995 General Fund Financial Statements. See Appendix A for a discussion of the audit scope and methodology.

Finding A. Presenting War Reserves on Financial Statements

War reserves valued in excess of \$31.3 billion in FY 1995 were incorrectly and inconsistently presented on the Army and Air Force General Fund Financial Statements. This occurred because guidance from the Under Secretary of Defense (Comptroller) (USD[C]) for presenting war reserves on financial statements conflicted with FASAB and OMB intentions for presenting war reserves; also, the DFAS Centers partially ignored USD(C) guidance for presenting war reserves on the financial statements. As a result, the DFAS Centers materially misstated the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements. Unless the DFAS Centers present war reserves consistently and in accordance with FASAB and OMB intentions, the FY 1996 and future DOD Consolidated Financial Statements and the FY 1997 and future Government-Wide Consolidated Financial Statements will be materially misstated.

FASAB and OMB Guidance for Presenting War Reserves on Financial Statements

Guidance recommended by the FASAB and published by the OMB did not address accounting policy for presenting war reserves on financial statements. War reserves are assets that represent the value of materials that, in addition to peacetime assets, are necessary to equip and support the increase in military requirements in the event of war, and to sustain operations until additional supplies can be delivered.

FASAB Guidance. Although the guidance recommended by the FASAB did not address the presentation of war reserves on financial statements, the FASAB did define Stockpile Materials. SFFAS No. 3, "Accounting for Inventory and Related Property," October 27, 1993, defines Stockpile Materials as "strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies." Assets shown on the Stockpile Materials line are not intended for sale in the ordinary course of business. The standard also excludes the following from Stockpile Materials: items that are held by an agency for sale or use in normal operations, items that are held for use in the event of an operating emergency, and materials acquired to support market prices.

Finding A. Presenting War Reserves on Financial Statements

When asked for clarification, a FASAB representative stated that the intent in creating the Stockpile Materials line was to include only those items specifically identified by law as being stockpiled. FASAB Standard No. 3 states, "It was the Board's intention to include only those items specifically identified by law as being 'stockpiled.'" The FASAB representative also stated that Stockpile Materials should include only items such as strategic petroleum reserves, helium reserves, and other items residing in the national defense stockpile.

FASAB Statement of Recommended Accounting Standards (FASAB Recommended Standard) No. 8, "Supplementary Stewardship Reporting," (scheduled for publication early in 1997 and required to be implemented in FY 1998) and subsequent definitions and interpretations will affect the future presentation of war reserves on DoD financial statements. The FASAB Recommended Standard No. 8 includes weapon systems PP&E under the Federal Mission PP&E category of Stewardship PP&E. On approval of an official definition of weapons systems PP&E, it is likely that at least a portion of DoD war reserves will be considered weapon systems PP&E and will fall under the Federal Mission PP&E category of Stewardship PP&E. The FASAB Recommended Standard No. 8 proposes that these Federal Mission PP&E items, as well as other stewardship assets, be removed from the Statement of Financial Position and presented as supplementary stewardship information instead. Regardless of which method is used, these items must be presented consistently in order to be accurately portrayed in all future DoD financial statements.

OMB Guidance. Although OMB accounting guidance did not address the presentation of war reserves on financial statements, OMB did define Stockpile Materials. The "November 1993 OMB Form and Content" defined Stockpile Materials as "strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. They are not held with the intent of selling in the ordinary course of business." An OMB representative stated that OMB agreed with the FASAB that the Stockpile Materials line was intended for items specifically identified by law as being stockpiled, and that DoD war reserves should not be included in Stockpile Materials.

In the absence of published guidance from the FASAB and OMB for presenting war reserves on financial statements, and partially disregarding USD(C) guidance to present war reserves as stockpile materials, DFAS presented Army war reserves as Stockpile Materials, PP&E-Construction in Progress, and PP&E-Military Equipment. DFAS also presented Air Force war reserves as Operating Materials and Supplies.

Finding A. Presenting War Reserves on Financial Statements

DFAS Presentation of War Reserves on Financial Statements

The DFAS Centers did not correctly or consistently present war reserves on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements. Table 2 shows how the DFAS Indianapolis Center and the DFAS Denver Center presented war reserves on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements:

Table 2. DFAS Presentation of War Reserves on FYs 1994 and 1995 Army and Air Force General Fund Financial Statements

FINANCIAL STATEMENT LINE ITEM:	ARMY		AIR FORCE	
	1994	1995	1994	1995
OPERATING MATERIALS AND SUPPLIES			X	X
STOCKPILE MATERIALS	X	X		
PROPERTY, PLANT AND EQUIPMENT - CONSTRUCTION IN PROGRESS	X	X		
PROPERTY, PLANT, AND EQUIPMENT - MILITARY EQUIPMENT	X	X		

The DFAS Indianapolis Center presented Army munitions war reserves as Stockpile Materials and PP&E-Construction in Progress, and equipment war reserves as PP&E-Military Equipment. The DFAS Denver Center presented Air Force war reserves as Operating Materials and Supplies.

The following describes how DFAS inconsistently presented war reserves on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements.

Army War Reserves Presented by DFAS Indianapolis Center. The DFAS Indianapolis Center presented Army war reserves in three different locations on both the FYs 1994 and 1995 Army General Fund Financial Statements:

- o about \$31.3 billion of war reserve ammunition and missiles (munitions war reserves) was shown as Stockpile Materials,
- o about \$0.4 billion of progress payments for munitions war reserves was shown as PP&E-Construction in Progress, and

Finding A. Presenting War Reserves on Financial Statements

o at least \$2.8 billion of equipment war reserves was included in PP&E-Military Equipment.

Presenting a portion of the Army's war reserves as Stockpile Materials is consistent with the USD(C) accounting guidance, but not with FASAB and OMB guidance. Also, for consistency, the \$2.8 billion of equipment war reserves included in PP&E-Military Equipment and the \$0.4 billion of progress payments for munitions war reserves should be presented along with the \$31.3 billion of munitions war reserves.

Air Force War Reserves Presented by DFAS Denver Center. The DFAS Denver Center presented Air Force war reserves as Operating Materials and Supplies on the FY 1995 Air Force General Fund Financial Statements. The DFAS Denver Center reported \$23.9 billion of Operating Materials and Supplies on the FY 1995 Air Force General Fund Financial Statements. Some of the \$23.9 billion was war reserves, and some was not. Although the specific amount of Air Force war reserves was available on Air Force QO6/978 Inventory Reports, the DFAS Denver Center did not use the reports to determine the amount of Air Force war reserves. Therefore, the amount of Air Force war reserves remains unknown and is included in Operating Materials and Supplies. Presenting war reserves as Operating Materials and Supplies conflicts with USD(C) accounting guidance and FASAB and OMB intentions. FASAB, OMB, and USD(C) accounting guidance defines Operating Materials and Supplies as tangible personal property to be consumed in normal operations. War reserves do not meet this definition because they are not consumed in normal operations.

The DFAS Centers cannot be expected to present war reserves correctly unless USD(C) guidance is consistent with FASAB and OMB standards. The following section discusses incorrect guidance issued by the USD(C) for presenting war reserves on financial statements.

USD(C) Guidance Compared to FASAB and OMB Guidance

USD(C) accounting guidance for presenting war reserves on the financial statements contradicts FASAB and OMB accounting guidance. Although guidance published by the FASAB and OMB did not address the presentation of war reserves on the financial statements, their definition of Stockpile Materials did not include war reserves. Also, representatives from both FASAB and OMB have

Finding A. Presenting War Reserves on Financial Statements

stated that war reserves should not be presented as Stockpile Materials. However, the USD(C) accounting guidance for presenting war reserves on the financial statements says that war reserves will be presented as Stockpile Materials, contradicting both FASAB and OMB.

o The "October 1994 DoD Guidance on Form and Content," Appendix 3-B, "General Instructions for Preparation of the Principal Statements," defined Stockpile Materials as "strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. Included are materials held as war reserves and/or stockpiles."

o The USD(C) April 3, 1995, "Update to the DoD Chart of Accounts" contains General Ledger Account Code (GLAC) 1573, War Reserve/Mobilization Stock. The account is defined as "the value of materials that, in addition to peacetime assets, are necessary to equip and support the increase in military requirement forecasts in the event of an outbreak of war and sustain operations until resupply can be effected."

o The "October 1994 DoD Guidance on Form and Content," Appendix 3-D, "Crosswalk From the DoD Uniform Chart of Accounts to the Principal Statements," stated that GLAC 1573, War Reserve/Mobilization Stock, should be posted to Stockpile Materials on the financial statements.

If the DFAS Centers follow USD(C) accounting guidance for presenting war reserves as Stockpile Materials on the financial statements, the FY 1996 Military Department and DoD Consolidated Financial Statements and the FY 1997 Government-Wide Consolidated Financial Statements will be materially misstated.

Action Needed to Correctly and Consistently Present War Reserves on Financial Statements

The DFAS Indianapolis Center presented munitions war reserves as Stockpile Materials, equipment war reserves as PP&E-Military Equipment, and progress payments for munitions war reserves as PP&E-Construction in Progress. However, the DFAS Denver Center presented war reserves as Operating Materials and Supplies. Unless USD(C) accounting guidance on war reserves is revised, the DFAS Centers will again misstate war reserves on the FY 1996 Military Department General Fund Financial Statements and the FY 1996 DoD Consolidated Financial Statements. The incorrect and inconsistent presentation of war reserves valued at over \$31.3 billion will cause the FY 1996 DoD Consolidated Financial Statements and the FY 1997 Government-Wide Consolidated Financial Statements to be materially misstated. Further, because DoD war reserves are material in amount (the Army has over \$31.3 billion) and do

Finding A. Presenting War Reserves on Financial Statements

not clearly fit any of the FASAB and OMB definitions for the asset lines we reviewed, DoD should create a separate line entitled War Reserves to accommodate DoD war reserve materials. A separate line for war reserves on the financial statements would ensure consistent presentation of a material and unique class of DoD assets.

Management Comments on the Findings and Audit Response

The USD(C) comments stated that the findings were based on definitions from a superseded OMB bulletin, and that the auditors' conclusions were based on undocumented conversations about unpublished standards.

Management Comments on Auditors' Use of OMB Bulletin No. 93-02. The USD(C) stated that the findings in the report were based on definitions required by OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," which was replaced by OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 29, 1993.

Audit Response. The findings in the report are not based on definitions in OMB Bulletin No. 93-02. To avoid any further unclarity, this report has been revised to remove or update any references to the superseded OMB Bulletin No. 93-02.

Management Comments on Auditors' Use of Undocumented Conversations About Unpublished Accounting Standards. The USD(C) stated that the conclusions in the report appeared to be based on undocumented conversations between auditors and the FASAB and OMB about unpublished accounting standards.

Audit Response. The audit work included a significant amount of coordination and agreement between the auditors and the FASAB and OMB. The results, we believe, are supported by the lack of FASAB and OMB objections to the facts and conclusions in this audit report. Any conversations with the FASAB and OMB regarding FEDGAAP were fully documented.

Recommendations, Management Comments, and Audit Response

A. We recommend that the Under Secretary of Defense (Comptroller) revise accounting guidance on the presentation of equipment and munitions war

Finding A. Presenting War Reserves on Financial Statements

reserves, including progress payments for war reserves, on all future DoD financial statements. At a minimum, this guidance should:

- 1. Require that all war reserves, including progress payments for war reserves, be posted to a General Ledger account in the 1590 series, entitled War Reserves;**
- 2. Create a separate Entity Assets line, entitled War Reserves, on all DoD financial statements; and**
- 3. Require that the new General Ledger account in the 1590 series, entitled War Reserves, be posted to the new War Reserves asset line.**

Management Comments. The USD(C) nonconcurred with the recommendation to revise accounting guidance for presenting war reserves by creating a separate war reserves line on the DoD general fund financial statements. The USD(C) agreed that war reserves should not be presented on the Stockpile Materials, Net line and stated that war reserves will be included on the Inventory, Net line of the financial statements.

Audit Response. The USD(C) agreed that past guidance incorrectly advised the Military Departments to present war reserves as Stockpile Materials, Net on financial statements. However, requiring war reserves to be presented on the Inventory, Net line places USD(C) accounting policy in conflict with FEDGAAP. As stated in this report, the Inventory, Net line is reserved for tangible personal property that is held for sale, in the process of production for sale, or to be consumed in the producing of goods for sale. The Military Department general funds do not have a sales mission; therefore, they do not include items that would be classified as Inventory, Net. War reserves on the Military Department General Fund financial statements are intended for use in the event of war and are not, in the ordinary course of business, intended to be sold or used in the production of goods for sale. War reserves should not be presented on the Inventory, Net line of the financial statements.

As stated in the audit finding, DoD war reserves are material in amount (the Army has over \$31.3 billion) and do not fit any of the FASAB and OMB definitions of an asset line. DoD should follow the guidance in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 29, 1993, to clarify the financial statements by creating a separate line for war reserves on the Military Department General Fund financial statements. OMB Bulletin No. 94-01 and its successor, OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, allow flexibility in developing financial statements, provided that modifications comply with FEDGAAP. OMB Bulletin No. 94-01 specifically permits the addition or deletion of financial statement lines, depending on the materiality of the amounts.

Finding A. Presenting War Reserves on Financial Statements

Because war reserves do not specifically fit any of the FASAB and OMB definitions of an asset line, the creation of a separate line for war reserves on financial statements is the only presentation method that would be in accordance with FEDGAAP. The current USD(C) accounting policy for presenting war reserves will remain an obstacle to rendering audit opinions on the Military Department General Fund financial statements. We request that, in responding to the final report, the USD(C) reconsider his position on our recommendation to revise accounting guidance and create a separate line, entitled War Reserves, on all DoD financial statements.

Finding B. Presenting Progress Payments on Financial Statements

Progress payments valued at about \$10.5 billion in FY 1995 were inconsistently presented on the Army and Air Force General Fund Financial Statements. Progress payments were improperly presented as Advances and Prepayments when they should have been presented as PP&E-Construction in Progress. This occurred because the USD(C) had not established adequate guidance for presenting progress payments on financial statements. As a result, the DFAS Centers materially misstated the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements. Unless the DFAS Centers consistently present progress payments in accordance with FASAB and OMB guidance, the FY 1996 and future General Fund Financial Statements and the FY 1996 and future DoD Consolidated Financial Statements will be misstated.

Definitions of Terms

To understand the issue of presenting progress payments on General Fund financial statements, three terms must be defined: progress payments, advances, and prepayments.

o Progress payments are expenditures for assets made before the assets are received. Most large fixed-price contracts require the Government to make progress payments to contractors to reimburse them for a specified percentage of the costs incurred during performance. Progress payments can be based on costs incurred by the contractor as work progresses under a contract, or on the percentage or stage of completion. The purpose of progress payments is to maintain the contractor's solvency until delivery of the finished asset.

o Advances are cash outlays made by a Federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. The Federal Acquisition Regulation (FAR) 32.102, "Contract Financing," differentiates between progress payments and advances by stating that because advances "are not measured by performance, they differ from partial, progress, or other payments based on the performance or partial performance of a contract." Examples of advances include cash disbursed to employees before business trips and cash disbursed under a contract before the contractor provides goods or services.

Finding B. Presenting Progress Payments on Financial Statements

o Prepayments are payments made by a Federal entity to cover certain periodic expenses before those expenses are incurred. Typical prepaid expenses are rents paid to a lessor at the beginning of a rental period.

FASAB and OMB Guidance for Presenting Progress Payments on Financial Statements

Although guidance recommended by the FASAB and published by the OMB does not specify how progress payments should be presented on the financial statements, the guidance states that progress payments are not Advances or Prepayments.

FASAB Guidance. SFFAS No. 1, "Accounting for Selected Assets and Liabilities," states that Advances and Prepayments do not include progress payments made on long-term contracts, and that progress payments made to a contractor based on the percentage of completion of a contract are not Advances or Prepayments. However, this guidance does not address progress payments based on costs incurred by a contractor. When we asked for clarification, a FASAB representative stated that the intent was to exclude all progress payments from the Advances and Prepayments line on the financial statements because progress payments are made toward the purchase of an asset and cannot be recouped. In contrast, the Government can recoup Advances and Prepayments from a contractor for nonperformance. However, the guidance does not indicate where to present progress payments on the financial statements.

OMB Guidance. The "November 1993 OMB Form and Content" did not address progress payments, but required that the summary GLAC 1450, Prepayments, be presented as Advances and Prepayments on the financial statements. When we asked OMB personnel for clarification regarding progress payments, they made a distinction between the 1450 series of GLACs and progress payments. The OMB representative stated that the 1450 series of GLACs should be used for recurrent prepayments of items such as rent, taxes, royalties, commissions, insurance, and supplies, not for progress payments. The OMB representative also stated that progress payments for buildings or weapon systems should be treated as Construction in Progress and should be posted to the 1720 series of GLACs, which is used specifically for Construction in Progress. Construction in Progress is presented on the PP&E line of the financial statements.

Although guidance recommended by the FASAB and published by the OMB did not state where progress payments should be presented on the financial statements, it clearly stated that the DFAS Centers should not present progress payments as Advances or Prepayments.

Finding B. Presenting Progress Payments on Financial Statements

DFAS Presentation of Progress Payments on Financial Statements

The DFAS Centers did not consistently present progress payments on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements. Table 3 shows how the DFAS Indianapolis Center and the DFAS Denver Center presented progress payments on the Army and Air Force General Fund Financial Statements:

Table 3. DFAS Presentation of Progress Payments on Army and Air Force General Fund Financial Statements

FINANCIAL STATEMENT LINE ITEM:	ARMY		AIR FORCE		
	1994	1995	1993	1994	1995
ADVANCES AND PREPAYMENTS	X	X			X
WORK IN PROCESS				X	
PROPERTY, PLANT AND EQUIPMENT - CONSTRUCTION IN PROGRESS	X	X	X		

The DFAS Indianapolis Center presented Army progress payments as Advances and Prepayments and PP&E-Construction in Progress. The DFAS Denver Center presented Air Force progress payments as PP&E-Construction in Progress in FY 1993, as Work in Process in FY 1994, and as Advances and Prepayments in FY 1995.

The following describes how DFAS incorrectly presented progress payments on the Army and Air Force General Fund Financial Statements.

Army Progress Payments Presented by DFAS Indianapolis Center. The DFAS Indianapolis Center incorrectly presented Army progress payments on the Advances and Prepayments line of the Army General Fund Financial Statements because USD(C) guidance on presenting progress payments was inconsistent. The DFAS Indianapolis Center used FY 1991 guidance from the USD(C) for presenting \$2.5 billion of Army progress payments on the FYs 1994 and 1995 Army General Fund Financial Statements. The DFAS Indianapolis Center

Finding B. Presenting Progress Payments on Financial Statements

presented \$0.5 billion of non-procurement-funded and non-research, development, test, and evaluation-funded Army progress payments as Advances and Prepayments. The remaining \$2 billion of progress payments was accurately presented as PP&E-Construction in Progress on the financial statements. However, about \$0.4 billion of progress payments was for munitions war reserves, and an unknown amount was for equipment war reserves. These progress payments should be presented as War Reserves on the financial statements (see Finding A). By presenting progress payments as Advances and Prepayments, DFAS was not following FASAB guidance. In addition, the DFAS Indianapolis Center's presentation of Army progress payments as Advances and Prepayments and PP&E-Construction in Progress was not consistent with the DFAS Denver Center's presentation of Air Force progress payments as PP&E-Construction in Progress in FY 1993, Work in Process in FY 1994, and Advances and Prepayments in FY 1995.

Air Force Progress Payments Presented by DFAS Denver Center. The DFAS Denver Center incorrectly presented \$8 billion of Air Force progress payments on the Air Force General Fund Financial Statements because USD(C) guidance on presenting progress payments was inconsistent. Without adequate guidance from the USD(C), the DFAS Denver Center presented Air Force progress payments on three different lines of the financial statements in FYs 1993, 1994, and 1995. The DFAS Denver Center presented Air Force progress payments correctly as PP&E-Construction in Progress on the FY 1993 Air Force General Fund Financial Statements. However, the DFAS Denver Center incorrectly presented Air Force progress payments as Work in Process on the FY 1994 Air Force General Fund Financial Statements and as Advances and Prepayments on the FY 1995 Air Force General Fund Financial Statements. By presenting Air Force progress payments as Advances and Prepayments, DFAS did not follow FASAB guidance. In addition, the DFAS Denver Center's presentation of Air Force progress payments was inconsistent with the DFAS Indianapolis Center's presentation of Army progress payments.

Under Secretary of Defense (Comptroller) Guidance

As a result of unclear USD(C) guidance, the DFAS Centers inconsistently and incorrectly presented DoD progress payments on the Army and Air Force General Fund Financial Statements. USD(C) guidance for presenting progress payments on the financial statements has been inconsistent and contradictory. Current USD(C) guidance contradicts FASAB and OMB guidance. USD(C) guidance for presenting progress payments on the financial statements is found in three different documents. Each set of USD(C) guidance contained different and contradictory accounting requirements for presenting progress payments.

Finding B. Presenting Progress Payments on Financial Statements

o The “October 1994 DoD Guidance on Form and Content” required progress payments to be presented as Advances and Prepayments on the financial statements.

o The “DoD Financial Management Regulation” gives three different requirements on accounting for progress payments; the Regulation states in three different sections that progress payments should be presented as Advances and Prepayments, PP&E-Construction in Progress, or Work in Process on the financial statements.

o A memorandum issued by the USD(C) in FY 1991 required that progress payments be presented as Construction in Progress.

The following is a more detailed discussion of the three sources of USD(C) guidance for presenting progress payments.

“October 1994 DoD Guidance on Form and Content.” The “October 1994 DoD Guidance on Form and Content,” Appendix 3-D, “Crosswalk From the DoD Uniform Chart of Accounts to the Principal Statements,” stated that progress payments for entity assets should be presented as Advances and Prepayments on the financial statements. Presenting progress payments as Advances and Prepayments contradicts FASAB Standard No. 1, “Accounting for Selected Assets and Liabilities,” which states that progress payments are not advances or prepayments.

“DoD Financial Management Regulation.” The “DoD Financial Management Regulation,” volume 4, “Accounting Policies and Procedures,” January 11, 1995, contains contradictory accounting requirements for the presentation of progress payments.

o Chapter 5, “Advances and Prepayments,” states that progress payments to contractors should be recorded as prepayments.

o Chapter 6, “Fixed Assets,” states that the Construction in Progress-Contractor account should be used to record progress payments to contractors on DoD real property facilities. Work in Process accounts should be used to record equipment (all personal property owned by DoD that is not an integral part of real property) being constructed for DoD.

FY 1991 USD(C) Memorandum. A memorandum issued by the USD(C) in FY 1991 stated, “Amounts paid in the form of progress payments. . . shall be reclassified as Construction-In-Process since payments made are for the subsequent delivery of a constructed item, not intended for sale.” The guidance also stated, “. . . amounts paid to contractors and others for the subsequent delivery of military equipment and related support systems, or for equipment or other items required in the performance of military support functions, shall be

Finding B. Presenting Progress Payments on Financial Statements

reclassified as construction in process." The later statement was subsequently revised in the "October 1996 DoD Guidance on Form and Content" to require that these payments be classified as progress payments.

Until the USD(C) accounting guidance is revised to show clearly how to present progress payments in accordance with FASAB and OMB guidance, the DFAS Centers will continue to inconsistently present progress payments on Army, Navy, and Air Force General Fund financial statements.

Action Needed to Consistently Present Progress Payments on Financial Statements

To ensure the consistent presentation of progress payments, USD(C) accounting guidance should identify which line of the financial statements the DFAS Centers should use to present progress payments. Progress payments should not be presented as Work in Process or Advances and Prepayments.

o Progress payments for weapon systems should not be presented as Work in Process. Although Work in Process is presented separately on FYs 1994 and 1995 Army and Air Force General Fund Financial Statements, The "November 1993 OMB Form and Content" consolidates all Work in Process GLACs as Inventory on the financial statements. Consequently, if progress payments on items such as weapon systems or other military equipment are presented as Work in Process on FY 1996 and future Army, Navy, and Air Force General Fund Financial Statements, these partially completed items will be presented as Inventory on the FY 1997 and future Government-Wide Consolidated Financial Statements. These items clearly do not meet the definition of Inventory. Inventory is defined by FASAB Standard No. 3, "Accounting for Inventory and Related Property," as tangible personal property that is held for sale, in the process of production for sale, or to be consumed in producing goods for sale or in providing services for a fee.

o Progress payments should not be presented as Advances and Prepayments. Progress payments based on costs incurred or on percentage-of-completion do not meet the current definitions of advances or prepayments. FAR 32.102 differentiates between advances and progress payments based on costs incurred or percentage-of-completion. FAR 32.102 states that since advances "... are not measured by performance, they differ from partial, progress, or other payments based on the performance or partial performance of a contract." In addition, progress payments do not meet the definition of prepayments because prepayments are only intended to cover periodic expenses such as rent and taxes; progress payments do not cover periodic expenses. Finally, the FASAB has stated its intention to exclude progress payments from Advances and Prepayments on

Finding B. Presenting Progress Payments on Financial Statements

financial statements because, although the Government can recoup advances and prepayments for nonperformance by a contractor, progress payments are made toward the purchase of an asset and cannot be recouped.

The USD(C) should work with the FASAB and OMB to clarify accounting guidance on the presentation of progress payments. This accounting guidance should state that, except for equipment and munitions war reserves (see Finding A), progress payments for DoD real property facilities (buildings and related structures) and personal property (weapon systems or other military equipment), should be presented as PP&E-Construction in Progress on the FY 1996 and future Military Department General Fund Financial Statements and the FY 1996 and future DoD Consolidated Financial Statements. (Because general fund appropriations do not include inventory, progress payments for inventory were not addressed in this report.) This will ensure consistent presentation of progress payments that represent partially completed PP&E assets. The assets being purchased by the progress payments will be shown as PP&E, along with military equipment and structures, facilities, and leasehold improvements. In an ongoing project, the "Audit of DoD Progress Payment Procedures" (Project No. 6FJ-2002), the IG, DoD, will further analyze the presentation of progress payments on all DoD financial statements and make appropriate recommendations. However, unless USD(C) accounting guidance on progress payments is revised and made consistent with FASAB and OMB intentions, it is likely that the FY 1996 Military Department General Fund Financial Statements and the FY 1996 DoD Consolidated Financial Statements will be materially misstated.

Recommendation, Management Comments, and Audit Response

B. We recommend that the Under Secretary of Defense (Comptroller), in coordination with the Federal Accounting Standards Advisory Board and the Office of Management and Budget, clarify accounting guidance for the reporting of progress payments to ensure consistent presentation by the Defense Finance and Accounting Service Centers on the FY 1996 and future Military Department General Fund Financial Statements and the FY 1996 and future DoD Consolidated Financial Statements.

Management Comments. The USD(C) nonconcurred with the recommendation to coordinate with the FASAB and OMB to clarify accounting guidance for presenting progress payments on DoD financial statements. The USD(C) stated that the DoD requirement for presenting progress payments is consistent with the U.S. Government Standard General Ledger and that progress payments should be

Finding B. Presenting Progress Payments on Financial Statements

presented as Advances and Prepayments. The USD(C) further stated that, to better ensure consistency, this DoD requirement was subsequently clarified in the "October 1996 DoD Guidance on Form and Content."

Audit Response. The USD(C) guidance for presenting progress payments on financial statements was incorrect in the "October 1996 DoD Guidance on Form and Content." This guidance erroneously requires that progress payments be presented on the Advances and Prepayments line of the financial statements. The USD(C) response equated a progress payment on a weapon system with an advance to a contractor. As stated in the finding, progress payments are not advances or prepayments and should not be presented as such.

The FASAB, which is willing to discuss and clarify FEDGAAP guidance, has indicated that progress payments are not advances and prepayments that can be recouped. Therefore, any DoD requirement to present progress payments on the Advances and Prepayments line of the financial statements is not in accordance with FEDGAAP guidance. If the USD(C) does not correct this erroneous accounting policy by coordinating with the FASAB and OMB to clarify accounting guidance for presenting progress payments on financial statements, the policy will remain an obstacle to rendering audit opinions on the Military Department General Fund financial statements. We request that, in responding to the final report, the USD(C) reconsider his position on clarifying accounting guidance for presenting progress payments on the Military Department General Fund financial statements. We believe that the OMB and FASAB can assist in this effort and should be consulted.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology. The audit was performed by a working group consisting of representatives from the IG, DoD, and the Military Department audit organizations. Because DoD has not yet prepared General Fund financial statements for the Navy and the Defense agencies, we limited our review to the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements. We focused on specific assets: Inventory; Work in Process; Operating Materials and Supplies; Stockpile Materials; Property, Plant and Equipment; and Other Entity Assets. These assets accounted for 82 percent (\$447.7 billion out of \$545.5 billion) of total assets presented on the FY 1995 Army and Air Force General Fund Financial Statements. For these assets, we:

- o reviewed FASAB, OMB, and DoD guidance related to presenting assets on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements, and

- o interviewed representatives of the FASAB, the OMB, the DoD financial community, and the DoD audit community about the presentation of assets on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements.

Audit Period and Standards. We performed this financial statement audit during the period November 1995 through August 1996. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit. The scope of the audit was limited in that we did not review the management control program.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD and the Federal Government. Further details are available on request.

Prior Audits and Other Reviews. No prior audits identified the reasons for inconsistent reporting of the assets we reviewed on the FYs 1994 and 1995 Army and Air Force General Fund Financial Statements.

Appendix B. Accounting Guidance

Accounting guidance for presenting assets on financial statements is found in several sources.

o Statements of Federal Financial Accounting Standards and Concepts, known as Federal Generally Accepted Accounting Principles, or FEDGAAP. The FASAB was established to recommend Federal financial accounting standards to the Secretary of the Treasury; the Director, OMB; and the Comptroller General, who are co-principals of the FASAB. The following table shows the status of Statements of Federal Financial Accounting Standards (SFFAS) and Concepts (FEDGAAP).

Status of SFFAS and Concepts (FEDGAAP)			
<u>Number</u>	<u>Title</u>	<u>Status</u>	<u>Date</u>
Standard No. 1	Accounting for Selected Assets and Liabilities	Final ¹	March 30, 1993
Standard No. 2	Accounting for Direct Loans and Loan Guarantees	Final	August 23, 1993
Standard No. 3	Accounting for Inventory and Related Property	Final	October 27, 1993
Standard No. 4	Managerial Cost Accounting Standards for the Federal Government	Final	July 31, 1995
Standard No. 5	Accounting for Liabilities of the Federal Government	Final	September 1995
Standard No. 6	Accounting for Property, Plant and Equipment	Final	June 1996
Standard No. 7	Accounting for Revenue and Other Financing Sources	Final	May 10, 1996
Standard No. 8	Supplementary Stewardship Reporting	Recommended ²	June 26, 1996
Concept No. 1	Objectives of Federal Financial Reporting	Final	September 2, 1993
Concept No. 2	Entity and Display	Final	June 6, 1995

¹Final: Issued for implementation by prescribed date.

²Recommended: Approved by the Joint Financial Management Improvement Program Principals and undergoing Congressional review.

Appendix B. Accounting Guidance

FASAB is evaluating natural resources, capital costs, and management discussion and analysis. FASAB also plans to evaluate the feasibility of producing a "Question and Answer Guide" giving information about the standards, and an "Expense-Expenditure Guide" to aid accountants and budget analysts in understanding the flow of costs and recognition of expenditures. Finally, FASAB plans to develop a single volume that will codify all FASAB concepts and standards.

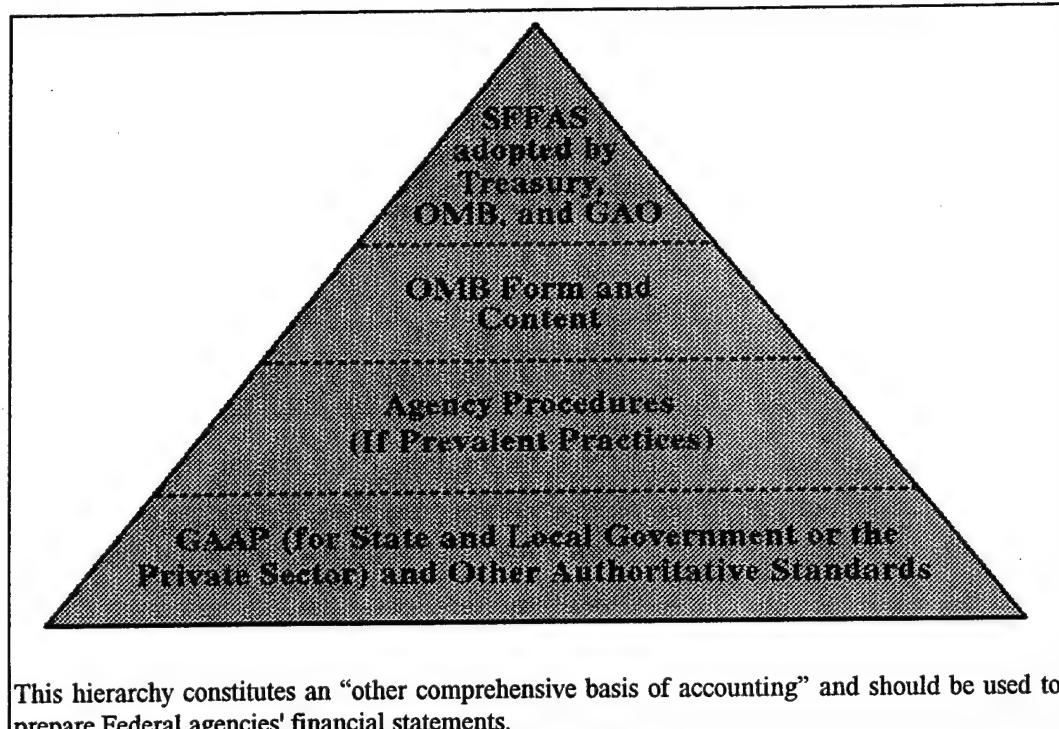
- o Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 29, 1993 (the "November 1993 OMB Form and Content") gives procedures for Government agencies to follow when preparing annual financial statements. The "November 1993 OMB Form and Content" was recently superseded by OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996 (the "October 1996 OMB Form and Content"),
- o "DoD Guidance on Form and Content of Financial Statements for FY 1994 and FY 1995 Financial Activity," October 20, 1994 (the "October 1994 DoD Guidance on Form and Content") contains procedures for DoD activities to follow when preparing annual financial statements. This guidance expands on the "November 1993 OMB Form and Content" and includes items that are specific to the preparation of DoD financial statements. The "October 1994 DoD Guidance on Form and Content" was recently superseded by "DoD Guidance on Form and Content of Financial Statements for FY 96 Financial Activity," October 1996 (the "October 1996 DoD Guidance on Form and Content"), and

- o DoD 7000.14-R, the "DoD Financial Management Regulation," volume 4, "Accounting Policies and Procedures," January 11, 1995, contains accounting policies and procedures that DoD organizations must follow. The Regulation describes in detail the purpose and application of specific DoD General Ledger accounts.

When determining which guidance to follow in preparing the Military Departments' financial statements, the DFAS Centers must follow the hierarchy of accounting policy guidance contained in the "November 1993 OMB Form and content."

Hierarchy of Accounting Guidance. The DFAS Centers prepare the Military Department General Fund financial statements based on a hierarchy of accounting standards. According to the "November 1993 OMB Form and Content," which should have been used to prepare the FYs 1994 and 1995 Military Department General Fund financial statements, at the top of the hierarchy were individual accounting standards proposed by the FASAB and published by the OMB (known as FEDGAAP). The second level of the hierarchy was guidance issued by OMB on the form and content of financial statements. When authoritative guidance was not available from FASAB and OMB, agencies were allowed to follow internal

accounting policies and procedures or agency procedures, provided they were prevalent practices throughout the Government. In the absence of specific guidance at the first three levels, the DFAS Centers could have followed authoritative standards such as generally accepted accounting principles. The following figure presents the hierarchy of accounting guidance used to prepare the FYs 1994 and 1995 Military Department General Fund financial statements.



Hierarchy of Accounting Guidance

This hierarchy changed with the publication of the "October 1996 OMB Form and Content." The new hierarchy is:

- 1) The Statement of Federal Financial Accounting Standards (SFFAS) and Concepts recommended by the FASAB and published by the OMB (FEDGAAP),
- 2) interpretations of the FEDGAAP published by OMB,
- 3) OMB guidance on form and content, and
- 4) generally accepted accounting principles (for state and local governments or the private sector) and other authoritative standards.

Appendix B. Accounting Guidance

As discussed in this audit report, this evolving hierarchy has become increasingly important as DoD policy and guidance expands on, and in some cases differs from, higher-level policy and guidance.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
Deputy Under Secretary of Defense (Logistics)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, U.S. Army Corps of Engineers
Director, U.S. Army Logistics Management College

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Ballistic Missile Defense Organization
Director, Defense Contract Audit Agency

Appendix C. Report Distribution

Other Defense Organizations (cont'd.)

Director, Defense Finance and Accounting Service

 Director, Defense Finance and Accounting Service Cleveland Center

 Director, Defense Finance and Accounting Service Columbus Center

 Director, Defense Finance and Accounting Service Denver Center

 Director, Defense Finance and Accounting Service Indianapolis Center

 Director, Defense Finance and Accounting Service Kansas City Center

Director, Defense Logistics Agency

Director, Washington Headquarters Services

President, Defense Acquisition University

President, Defense Systems Management College

President, Uniformed University of the Health Sciences

Inspector General, National Imagery and Mapping Agency

Non-Defense Federal Organizations

Federal Accounting Standards Advisory Board

Office of Management and Budget

Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees
and subcommittees:

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on National Security, Committee on Appropriations

House Committee on Government Reform and Oversight

House Subcommittee on National Security, International Affairs, and Criminal Justice,
Committee on Government Reform and Oversight

House Committee on National Security

Part III - Management Comments

Under Secretary of Defense (Comptroller) Comments



**OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100**



NOV 14 1996

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Draft Audit Report on Nonfinancial Asset Presentation on Military Department General Fund Financial Statements (Project No. 5FI-2012.03)

This is the Office of the Under Secretary of Defense (Comptroller) response to the subject draft audit report. The report includes two recommendations directed to the Under Secretary of Defense (Comptroller). This office does not agree with the conclusions reached by the auditors in the findings, nor with the recommendations based upon those findings.

The findings are based upon definitions required by the Office of Management and Budget (OMB) Bulletin 93-02; however the OMB Bulletin 93-02 was replaced by the OMB Circular 94-01, "Form and Content of Agency Financial Statements," dated November 16, 1993, and was effective beginning with financial reports for FY 1994.

The audit report conclusions appear to be based upon undocumented conversations between the auditors, representatives of the Federal Accounting Standards Advisory Board and the OMB concerning unpublished accounting standards. Such conversations appear to represent only individual and nonauthoritative interpretations of such unpublished standards.

My response to the recommendations is at the attachment. My point of contact on this matter is Mr. Oscar G. Covell. He may be reached at (703) 697-6149 or e-mail: covello@ousdc.osd.mil.


Alvin Tucker
Deputy Chief Financial Officer

Attachment

Under Secretary of Defense (Comptroller) Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)
COMMENTS ON DRAFT AUDIT REPORT ON
NONFINANCIAL ASSET PRESENTATION ON MILITARY DEPARTMENT
GENERAL FUND FINANCIAL STATEMENTS
(PROJECT NO. 5FI-2012.03), DATED SEPTEMBER 27, 1996

Recommendation A: We recommend that the Under Secretary of Defense (Comptroller) revise accounting guidance on the presentation of equipment and munitions war reserves, including progress payments for war reserves, on all future Department of Defense (DoD) financial statements. At a minimum, this guidance should:

- (1) Require that all war reserves, including progress payments for war reserves, be posted to a general ledger account in the 1590 series entitled War Reserves
- (2) Create a separate Entry Asset line on all DoD financial statements entitled war reserves
- (3) Require that the new general ledger account in the 1590 series, entitled War Reserves, be posted to the new War Reserves Asset line

DoD Response: Nonconcur. The DoD form and content guidance on the preparation of financial statements for FY 1996 requires that War Reserves (which includes items that, inadvertently, were misclassified as stockpile materials in prior years) be included on the "Inventory, Net" line of the financial statements. The line entitled "Stockpile Materials, Net" is reserved specifically for use by the National Defense Stockpile Transaction Fund.

Recommendation B: We recommend that the Under Secretary of Defense (Comptroller), in coordination with the Federal Accounting Standards Advisory Board and the Office of Management and Budget, clarify accounting guidance for the reporting of progress payments to ensure consistent presentation by the Defense Finance and Accounting Service Centers on the FY 1996 and future Military Department General Fund financial statements and the FY 1996 and future DoD Consolidated Financial Statements.

DoD Response: Nonconcur. The DoD requirement for recording progress payments for weapons systems is consistent with the U.S. Government Standard General Ledger published by the Department of the Treasury on April 12, 1996. The U.S. Government Standard General Ledger provides for the recording of advances to contractors in standard general ledger account 1410, "Advances to Others." General Ledger account 1410 crosswalks to line 1.b.(5), "Advances and Prepayments," on the Statement of Financial Position. However, to better ensure consistency in the presentation of such amounts in the Chief Financial Officer financial statements, the Office of the Under Secretary of Defense (Comptroller) has clarified, in the DoD form and content guidance on the preparation of financial statements for FY 1996, the proper presentation of such amounts.

Attachment

Audit Team Members

This report was produced by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Asset Presentation on Military Department General Fund Financial Statements

B. DATE Report Downloaded From the Internet: 10/27/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
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400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: VM **Preparation Date** 10/27/99

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